RESPONSIBILITY OF THE NATIONAL BANK IN THE PRESENT CRISIS

The National Bank Act in some respects is the most important measure ever passed by any government on the subject of banking. If an Englishman were asked what has been the greatest banking law he would doubtless reply, "The Act of 1844." But this act was simply regulatory and in amendment of former acts, putting an existing institution—the Bank of England—on a more efficient footing. The National Bank Act created a new national system—a system under which the dominant banking institutions of the western continent have been organized, a system embracing over four thousand five hundred individual banks and employing a capital of about $1,200,000,000.[1] This act, in other words, is one of such prominence in our legislation and in our thought about active business life that we lose sight of all others. We forget that there are in existence over forty state laws and state systems of banking under which quite as many banking houses at present exist. The national banks are a great centrally controlled, unified system of commercial credit, serving a nation in which commercial credit is more largely used than in any other quarter of the globe.

One of the things necessary to commerce is a genuine, honest money, a money that will pass anywhere within the range of commercial enterprise. Under the state banking systems that existed prior to the passage of the National Bank Act, commercial bank currency was at once complex and unstable, in many cases worthless. We had all kinds of money, good, bad and indifferent. To overcome some of the disadvantages arising out of this state of things Mr. John Thompson, founder of the Chase National Bank, published *The Bank Reporter,* a monthly periodical showing the discounts at which the various kinds of bank notes that did not circulate at par were quoted. These lists filled each month a book of about one hundred pages. A merchant or a business house having a wide clientele would have to keep this key or guide constantly at hand

[1] Stock capital, $701,990,554; surplus capital and undivided profits, $482,377,443; total, $1,184,367,997 (July 16, 1902).

as a basis for judgment in dealings with customers. A man from Ohio would go to New York and buy a bill of goods and offer a roll of Ohio bank bills in payment. The merchant would take out his *Bank Reporter* and find out whether the bank money offered was worth anything, if so, how much. Every bill offered was looked on in a skeptical sort of way, every note was viewed with suspicion. People were afraid of paper currency. The discounting of notes became a regularly established business.

Conditions Out of Which the National Bank Rose

In the midst of the currency irregularities arising from the multiplicity of systems upon which the country was thrown after the failure to recharter the second Bank of the United States came the Civil War. The Government failing to find a suitable bond market, issued greenbacks as a means of paying current expenses. In order to give these currency, they were made legal tender for the payment of debts. The result was to force all coin out of circulation and to reduce the reserves of banks—the commercial credit institutions—to a paper basis. Now, the unsteady and incongruous state bank systems were forced to build their credit superstructures on a paper foundation that rose and fell with the fortunes of the government. It was to correct the intolerable evils arising out of this state of the currency and at the same time to create a market for the long-time obligations (the bonds) of the Government that the National Bank Act was planned.

Essential Features of the National Bank Act

The essential features of the National Bank Act were drawn from the combined banking experience of over half a century before. They are as follows:

1. The passage of a general law under which all national banks must be incorporated, thus removing the obtaining of special business privilege from political influence and making the granting of charters a matter of administrative discretion. This method was first adopted in New York as the result of practices there which made the organization of banks and the granting of special charters a part of party spoils and involved the government in wholesale corruption. In 1820 this practice was corrected by constitutional amendment.

2. The creation of a central bureau or department of government under the direction of a comptroller, whose duty it was to look into the character of subscribers, compliance with the bank act with reference to the prepayment of capital, the good faith of incorporators, etc. This practice, originating in New England, was at first instituted by the banks themselves under the Suffolk system, for the protection of those conducting a legitimate business. It was directed against the evil practices of bank speculators and the organizers of institutions, the prime purpose of which was to impose on the public.

3. A system of central examination and control conducted under the supervision of the comptroller as a means of determining whether the law was being complied with, thereby avoiding fraud and deceit on the part of those who attempted to subvert it. This also grew out of New England experience, where from the early part of the century banking had been placed on a firm specie-paying basis. Massachusetts has the honor of instituting central examination as a means of preventing wildcat banking.

4. Uniformity of issues redeemable in government notes and secured by government bonds.

5. A double liability clause which imposes on each stockholder financial responsibility for the bank in double the amount of his stock. This may be said to have been an original contribution made by the national bank system and has since been adopted by most of the states in framing their laws.

6. A plan of clearing, or central redemption, of the notes of all of the banks in the system, thereby preventing inflation.

7. The reserve requirement. By this all institutions in the system are compelled to keep a lawful money reserve for the redemption of outstanding demand credit accounts or "deposits." This feature was appropriated from the Louisiana banking law. There had been several failures in the state following the panic of 1857. Efforts to prevent a repetition of banking "on wind" led to the requirement of a 25 per cent cash reserve. Following the example of Louisiana, Ohio introduced the reserve system but made a new contribution in the way of dividing the banks into two classes, which correspond to what are now known as "country banks" and "city reserve banks."

Defects of the System

In general the national bank has been eminently successful. It has given uniformity and stability to our banking currency and supplanted the unsatisfactory state bank issues. It has given to the public a sound and conservative basis for commercial credit and reclaimed business from the chaos surrounding it prior to its establishment. In only two features has it shown weakness, (1) in its provision for issue, which at the time of framing was primarily based on the necessity for supporting the bond market, and (2) in the working of its reserve system in time of great financial pressure. It is these two features that have a special bearing on the impending crisis in Wall street, which, if averted, will only leave the system subject to a recurrence of the evil under similar conditions. Were these remedied, ours would be the most perfect banking system in the world.

The chief peculiarity of a deposit system of banking is that the larger portion of deposits received is loaned. This is the agreement implied or expressed when deposits are made and the bank expects to fulfil the contract. Usually the receipts do not vary greatly from the daily payments, consequently under ordinary circumstances the obligation is not difficult to fulfil, but there are times when a sudden and unexpected demand is made for a large quantity of deposits; then the difficulty in complying is keenly felt. No permanent increase in the currency, however large, can bring relief, for business will naturally adjust itself to the larger volume and after this adjustment has been made the difficulty of responding to extraordinary demands of depositors will be as great as before. Nor do the usual modes of enlargement operate with the required speed. Plans for the increase of issues have been proposed which are practical, and one of these plans ought to be adopted without delay. Until this is done a heavy cloud must necessarily hang over the banking system. Not until a safe way is adopted for responding quickly to all extraordinary as well as ordinary demands of depositors will banks ever feel easy in conducting their business. Let a bank be conducted with the utmost prudence, under present conditions, and an impending avalanche is always in sight.

The other defect in the national banking system we find in the working of the reserve; this is one to which attention will be chiefly

drawn at this time. In the early days of the law the one principal objection to it was the amount of reserve required. The objectors said they knew better than the government how much reserve they ought to keep, and that it was an impertinence on its part to fix the amount for them. The objection came in truth from that large class of bankers who believe in lending to low-water mark, who do not hesitate to take the largest risks—in short, are animated with the desire to gain the largest profits, and, for the sake of gaining these, are willing to incur every danger of loss. Conservative bankers regarded both features of the law with much favor, and insisted on their retention. By the law, as originally drawn, each bank was to keep its own reserve, thus having it at complete command. Several modifications were suggested; reduction of the amount was the most popular. Finally, it was proposed that the country banks, as they were called, should be permitted to keep a portion of their reserve with the banks in the larger cities—the compromise being taken from the banking law of Ohio. Thus modified, the reserve feature was made acceptable, and the system grew rapidly in favor.

By this plan Congress had provided for the organization of banks into three classes: the banks located in New York were designated as belonging to the *first* class, and were required to keep on hand a lawful money reserve of 25 per cent of their deposits. They were to be known as the "central reserve city banks." Banks of the *second* class were also required to keep on hand 25 per cent of their deposits, but could confide the keeping of one-half of this amount to the banks in New York. The banks belonging to this class were called "reserve city banks;" they were located in sixteen of the leading cities: Albany, Baltimore, Boston, Cincinnati, Chicago, Cleveland, Detroit, Louisville, Milwaukee, New Orleans, Philadelphia, Pittsburg, Richmond, St. Louis, San Francisco and Washington. Banks of the *third* class included all others and were required to keep a reserve equal to 15 per cent of their deposits. Of this sum the law required them to keep only 6 per cent at home, the remaining 9 per cent could be deposited with a national bank in a reserve city. These are commonly called "country banks." Since the enactment of the law ten cities have been put in the reserve list, and Chicago and St. Louis have been transformed into "central reserve cities" like New York.

All of the banks in the "reserve cities" keep their reserve, as

permitted by law, with one or more banks in a central reserve city; while the "country banks" keep their reserves in one or more banks in a "reserve" or "central reserve" city. If a country bank deposits this portion with a national bank in Philadelphia, for example, the deposits of the Philadelphia bank are increased to a similar amount. One-fourth of this, or 25 per cent, must be kept on hand by the Philadelphia bank, but one-half of this amount, or one-eighth of the whole, may be deposited with a bank in a central reserve city. It follows therefore that the national banks in the three central reserve cities may, and generally do, keep one-half of the reserve of the national banks of the reserve cities, also the reserves of all the country banks that are deposited directly with them, and one-eighth of the reserve of country banks sent by them to the banks in the reserve cities outside the pale of the three central ones. What is the advantage of such a system of reserves? Why would a bank desire to send away, in other words to loan, a large part of its reserves? The answer is very simple. To earn profit. At home it could be put away in a vault for an emergency; it is by some looked upon as dead money. If dead, it is exercising a potent function, for, besides possessing the power to come into instant and powerful life, it may at all times be considered as the foundation of all outstanding credit and its existence, though unseen, exercises a strong conservative influence in preserving a healthy money market.

How the Reserve is Diverted

What is done by the reserve keepers with the money sent to them? Do they put it away in their vaults until demanded by its owners? Far from this. Banks are not philanthropists, and do not profess to be. Pleased as some banks are to make a great show of deposits, not one of them would keep the reserve of another bank and be responsible for its loss, if it could not make some profitable use of the money thus confided to its keeping; in other words, could not lend it to advantage. But if it is lent, then it surely is not in the vaults of the bank. One cannot eat his cake and keep it too. Moreover, this reserve is not kept any longer than is necessary. The receiving bank has agreed to pay the sending bank something for the use of the money, it must therefore lose no time in lending it in order to earn the sum that must be paid, and also something beside

as a profit for itself. There is nothing legally or morally wrong in such action; the law implies that this is to be done; and the bankers, when yielding their submission to the law and organizing or re-organizing their institutions as national banks, expected to use this portion of their reserve in the manner above described. The fault lies in the law and not in the bank. But what becomes of the fundamental idea of a reserve when the money is not thus kept, but loaned out? It is a misuse of words to call this fund a reserve; it is a mockery; and every banker engaged in national banking knows it. The reserve thus sent away and loaned is not a reserve in any true sense of the term; the bank has simply a record of the existence of the money; a few lines and figures in a ledger. The money itself is flying on the wings of speculation, no one knows where.

To do this, we repeat, is legal, but the reserve is thereby destroyed. What, then, is the course of a receiving bank in lending the reserve of another bank committed to its care? As it has agreed to return the money on demand, in order to have the money at command it is usually loaned at call. A bank by lending it in this manner is supposed to have full control of its money. How delusive this supposition is we shall now proceed to show.

Why the Reserves May Not Be Had When Needed

These loans are made almost wholly to a single class of individuals, speculators either directly or through their agents or brokers. Security usually is given in the way of listed stocks, with a margin for shrinkage, and if the loans are not paid when they are called, the stocks can be sent to the exchange where they are listed, and sold. If a surplus is left from the sale, this belongs to the borrower; if there is a deficit, he is responsible therefor. This seems a very simple process of lending, but experience proves the process to be less simple occasionally for borrowers to fulfil their obligations, or for lenders to get back their money. In ordinary times if a bank in New York calls a loan and the borrower cannot conveniently pay, he negotiates a new loan on the same security with another bank and pays the money to the first lender. But if many loans are called by different banks the process is not so easy. A's loan by the Arctic National Bank is called and he, suspecting no difficulty in negotiating another, goes to another bank for that purpose. He

there learns that it cannot lend to him because it is also calling loans, and has therefore no funds to lend. He is greatly surprised, after applying to several of them, to learn that all are doing the same thing; and the unwelcome discovery is made that he cannot obtain a loan from any one of the entire number. But cannot he sell his security and get the money from this source? Of course he can —in theory. In fact, he cannot.

All the other borrowers whose loans have been called are in the same situation as A; all wish to negotiate loans, but not one of them can succeed any better. All are on the same plane; the man who has gilt-edged securities, as well as the man who has the most questionable ones. They cannot borrow for the reason that all the banks are calling loans; all want money. Why is it needed? Because the country banks have recalled their deposits. To this it is said that borrowers may sell their stock. But can they? The exchange is open, to be sure. But, in order to sell, there must be buyers. No one can buy when there are no funds available to pay for purchases. This is precisely the situation. The only course open is to borrow from outsiders. These, however, are depositors; and in making loans new demands are made on the banks for payment of deposits. This may again operate to reduce the reserves, which in turn forces them to "call." The market instantly collapses because so many wish to sell collaterals, and so few are in condition to buy. There are persons enough to know that, at the prices offered, stocks are very low, and will surely advance, but they cannot buy because they have no funds and cannot borrow, except at exorbitant rates. The banks, usually most willing and glad to lend, are suddenly prevented from lending because depositors are demanding their money. Loans, therefore, at such a time, are practically impossible.

This is one of the peculiarities of call loans which render them so unsatisfactory; when one or a few country banks demand their balances, usually the cause leading to such action by them is general, and all the rest make a similar demand, and at nearly the same time. This is the reason why call loans based on listed securities are often but little more than call loans in name. Again, if the stocks are thrown on the market and sold, several serious consequences may follow. As their value has greatly depreciated, or will inevitably decline if this be done; the bank which proposes to do this may not get enough from the sale to pay the loan. Furthermore, the sacrifice

of the securities in this manner may imperil the borrower, or bankrupt him, and thus in the end the bank will be a loser. Of course, it has a legal claim on the borrower for the unpaid balance of his loan; but this is a poor asset if, as a consequence of sacrificing his stock at a time when by reason of the peculiar condition of the market it has not brought half its real worth, he has been thrown into insolvency with perhaps little hope of ever recovering himself.

Legitimate Business Made to Suffer for the Follies of Speculation

What, then, can a bank do? It may, and generally does try to save the borrower at such times by not sacrificing his stock. But it must have money to pay the demands of the banks; from what sources, if any, can it be obtained? It cuts off its loans to others,—to those who are engaged in mercantile business, and as loans mature, the reservoir is filled and the funds thus obtained are sent to the banks in response to their demands. This is the modern mode of meeting the situation. The merchants and others who are the most worthy of assistance, who have done nothing to cause this trouble, are sacrificed to save the speculators. This is the exact truth and it is not pleasant to contemplate. A class of persons whom the banks are primarily organized to assist in the way of lending them the funds needful are sacrificed to save persons who are engaged in a business which the statutes and courts of almost every state condemn as unlawful.

This difficulty is accentuated by the bank practice of sending additional funds at the dull season of the year, when they cannot be employed at home, to New York because the New York banking institutions find a market for them. How? Only in one way—by lending them to speculators. This is known well enough by the sending banks, but the desire of profit is so great that, notwithstanding the use which they know will be made of their deposits and the difficulty perhaps they will have in getting them back without squeezing to some extent the most deserving classes of borrowers, they are sent. The responsibility, however, is very largely with the receiving bank, for it is its constituency that gets squeezed and its solvency that is first threatened. Both sending bank and receiving bank act on the very narrow, though very common, principle of

enriching themselves regardless of the consequences to others or to the country generally.

The Present New York Situation

Such a situation is confronting the New York banks to-day. The country banks are demanding their balances as they have a right to do, and they must be paid. The banks have been calling their loans, and borrowers are frantic because they cannot renew them from some other source. The banks, to save them, are cutting off, to some extent, their loans to regular borrowers, the merchants and the like, and are calling on the Government to give them a fresh supply of money. The Secretary of the Treasury has come to the rescue and has poured into their depleted coffers the public funds. To give some excuse for asking this assistance from the Government the banks and their call-loan borrowers, the brokers especially, are putting forth the preposterous claim that the Government is largely to blame for this congested condition of the money market in New York, by withdrawing money from the ordinary channels of circulation and hoarding it in the Sub-Treasuries. Others, who ought to know better, believing this, loudly demand the abolition of the Sub-Treasury system, declaring that it is antiquated and only a disturber of the ordinary and natural flow of the circulation; that it is a kind of gigantic fateful animal which sucks away the circulating medium, the life-blood of commerce, and then disgorges when it suits its own arbitrary purposes.

There is a class of bankers, reinforced by the speculative class, who believe in putting into banking institutions every dollar of the public funds, because, as it is said, they can be more efficiently and profitably used. This is true with reference to the income and profits of the bank so long as no demand is made on the Government, and no extraordinary demand is made on the bank; but it does not follow in the long run, that this is the wisest use to make of all the public money. Of course, a nation should make the wisest use of its money; but the wisest use of a considerable portion of the money medium, so many conservative bankers believe, consists in keeping it as a basis for credit. The conservative banker maintains that the largest profits are to be made by prudent lending and by always having on hand such a reserve as to insure the integrity of the

credit system. The adventurous banker would lend more freely, but takes greater risks. The entire question is concentrated in these two conceptions. Do the exigencies of banking or of business in general, call for keeping any considerable sum of money as a reserve; if so, where shall it be kept and what exigencies will justify its use? The conservative banker believes that a reserve is needful, and that if it is not kept, monetary disturbances and financial failures will come, resulting in heavier losses to the banks than the loss of interest on the disused or reserve portion of the fund.

The non-conservative banker is distressed in seeing any money around anywhere without having it out at interest and has undoubted faith that if every dollar were constantly employed in this way there would be no occasion for borrowing trouble concerning the future; that when the exigency comes a way will be found for encountering successfully the storm. So thought a New York bank president a few years ago and, acting on this belief, lent all of his reserves. As his bank was a state institution he was violating no law in thus conducting its business. When a storm broke in Wall Street—and the wisest cannot always foresee their approach—and the depositors in his bank made an unexpected demand for deposits, he applied to the clearing-house for relief. The clearing-house banks at once lent him ample funds and the danger of failure speedily passed away. Profiting nothing by this experience, after the storm was over, he went on in the old way, lending as freely as before. A year or two afterward there was another run on his bank and again he had the unblushing courage to apply to the clearing-house for relief. Probably he would not have done so had there been any other alternative than to close the bank doors and put out a notice, "Suspended." Again the clearing-house gave prompt and effective relief. But when the danger had passed, the clearing-house through a proper committee took another step. They notified the directors of the bank that, if they did not retire their president and elect another possessing different conceptions of banking, the next time a run occurred on their bank no assistance by the clearing-house would be given. This warning was effective and the president who did not believe in having any disused non-profit money around, in making an investment of a few dollars in an umbrella for a rainy day, was promptly retired.

It is true that this question is closely united with that of an

emergency currency. In other words, if a system were adopted of providing for an ample, safe and quick expansion of notes, there would indeed be less need of keeping a reserve. But under all circumstances a reserve is necessary. Bank notes are obligations of the same kind as open accounts. On demand they must be met. Not to keep a reserve is to attempt to build a house on the crater of an intermittent volcano, knowing that, at any time, it may burst with appalling effect. If the Government and the banks were short-sighted enough to put their entire resources into the stream of circulation, the speculator would indeed rejoice, for the invention of new scares to upset the market would be easier than before. In truth, this has been done more than once when the monetary supply was low, or could be made so by artifice. Draw out the last dollar from the reservoir and the speculator would incessantly proclaim the danger of a monetary drouth, and with this potent argument for breaking down prices would proceed with his accustomed cheerfulness to the task.

In truth, the present situation utterly overthrows the very assertion for which the non-believers in a reserve are contending. For why is the stock market in such a panicky condition? Simply because there is a lack of funds for the speculators to continue operations. And why does this lack exist? Because the New York banks are required by outside banks and other depositors to pay their deposits, and the monetary reserve held by them is running low. The only way in which this state of things would be improved is by having a reserve to respond to this demand. If the reserve system were broken up, if the Government abolished its present system of keeping its own, there would be no reserve anywhere, either to fulfil the proper demands of the country banks or of the Government itself; the catastrophe of 1837 would be repeated.

Attitude of the Government Towards the Reserve

It is true that the mode of administering the bank reserve by the Government is open to fair criticism. The object of a reserve is to use it in unusual emergencies; the official conception has been too often that it must not be used at all. For, as soon as a bank is seen to be below the line, it is carefully watched and, if the deficit is not soon made good, it is notified that this must be done at an early date.

This is effected by cutting off new loans and as the old ones are paid the reservoir is re-filled. This is the usual process. It is indeed the duty of the government to watch the reserve barometer, but it does not follow that a bank should always keep its reserve full. Mr. Knox, who for so many years filled efficiently the office of Comptroller, told the writer that he thought the Government on many occasions had executed the law too rigidly, had not permitted the banks to use their reserve with enough freedom, and that, if this had been done, there would have been less excitement and fear of monetary trouble. But now, under the rigid and unbending execution of the law, when a bank reaches its reserve, it has practically nothing left, and this is one of the reasons for so much fear. If the banks were permitted to dip more deeply into their reserve and keep it out for a longer period, always, of course, under the eye of the Comptroller, there would be less fear of financial distress; demands would be easily met and loans would be more freely made. A more liberal administration of the law in this regard would yield immediate relief. Furthermore, such a practice would be quite in harmony with the best foreign banking methods. The principal foreign banks, like the Banks of England, Berlin and the Austro-Hungarian, keep large reserves. They realize their responsibility, understand for what purpose a reserve should be kept. They therefore use their reserves more freely than the national banks, and with the desired results. But their margin is a much larger one on which to operate. The reserves are used on unusual occasions and as soon as these pass away it is accumulated. This course our banks should be permitted, in my opinion, to follow, and so long as they did not abuse the privilege and use their reserve for ordinary profit, the Comptroller should not interfere with their action.

So, too, the Government ought to be careful in not keeping out of circulation any unusual amount of money. The ordinary amount that is kept in the Sub-Treasuries does not affect in any way the usual course of business, because it is adjusted to the normal condition of things. But the locking up of any considerable excess, though this is done simply by receiving it as ordinary income and keeping it until needed to make regular payments, may disturb business by rendering the supply of money scarce. The financial head of the Government, though, has almost always realized the need of business in this regard and rarely has failed to turn more than the

excess into the channels of circulation. Consequently there is little room for criticism of his conduct in absorbing the revenues.

Disturbances Arising from Withdrawals of Individual Depositors

Beside the disturbance that may arise from the action of the Government in diverting currency temporarily from the great stream, and the action of the country banks in withdrawing their deposits from the reserve centers, especially from New York, and thus disturbing the ordinary speculative demands, the money market is also affected somewhat by a class of depositors who, at times when money commands a high rate of interest, withdraw their deposits in order to use them more profitably. Thus a thrifty depositor who can make no use of his deposit himself or who perchance is looking forward to an evil day, puts it in a New York bank and receives 2 or 3 per cent interest. After a few months perhaps the money market advances and commands 8 or 10 per cent. The depositor demands his money and the bank complies, though in doing so borrows perhaps at a rate which sweeps away all the profit from the use of the deposit, and in many cases far more; there is a heavy loss. Truly this is a pretty sharp business, on the part of a depositor; but if a bank is unlucky enough to be drawn into the net, it must pay for its folly. Unhappily, many banks are so eager for deposits they pay little regard to the ways of their owners, and consequently are sometimes caught in the manner above described. In truth, this type of depositor is more common than many imagine. A bank that is caught by one of them does not advertise the exploit. Corporations, too, are sometimes guilty of a similar practice. Learning that the rates of money have suddenly advanced they call for their balances and for a short period turn bankers. These unusual demands for money disturb still more the normal course of banking, coming as they do, at the same time as the other unusual demands already described. Yet all of them could be easily met by a bona fide reserve system and an effective method of expanding bank circulation.

In this connection may be mentioned the charge that some of the New York banks manipulate or force a rise in the money market in order to enhance their profits. Secretary Shaw has stamped this charge as baseless, and surely it would be difficult to discover any proof. Nevertheless those who know most about the ways of Wall

Street believe that, at times, some of the banks which have numerous dealings with speculators make them pay dearly for their loans because the banks command the situation and think it worth while to administer to them a lesson concerning the uncertainties and displeasures of speculation, since in so doing the banks are acquiring so much cold money profit for themselves. Indeed, if it were not for the expectation of a very considerable rise in the rates during a part of the year, banks in many cases would be unwilling to pay the rates they do on deposits during the dull seasons.

How to Remedy the Present Weakness in the Banking System

What, then, is the remedy? If we are right in the above exposition, the remedy is very simple. First, every national bank should keep its own reserve. It is, as we have said, a mere cavil for a bank to lend part of its reserve to another, which is loaned out by the receiver, every dollar, spread on the wide sea of circulation, and still call it reserve. This farce should be immediately ended. Every bank should keep its reserve in its own vaults, and if 25 per cent or 15 per cent is more than ought to be kept, the amount should be diminished. Perhaps if a country bank kept 10 or 12 per cent it would be sufficient; perhaps a bank in a reserve city would be justified in keeping not more than 15 per cent. Whatever the amount, every dollar should be kept at home, and then it would be a bona fide reserve.

Banks, other corporations and large business concerns keep accounts in New York for the purpose of drawing upon them, and this of course is in harmony with the most approved modes of doing business. A bank customer living in Oshkosh, Wis., desires a draft on a bank in New York. His bank can readily accommodate him and this is a real service. Banks ought not to be fettered in any way from keeping deposits elsewhere as a basis of such business. But the amount thus kept away from home should be no larger than is needful to conduct ordinary exchange operations. This fund often accumulates from collections. A bank in St. Louis has an arrangement with a bank in New York to collect all checks sent to it by the other, and settlements are made weekly or as often as they may agree. This is one of the ways in which banks come into the possession of money belonging to other banks. Of course, this business is proper

in every regard. What forms just ground for criticism is the sending or leaving money in the great speculative centers which both keeper and owner know will be used in speculative operations.

This should not be permitted for several reasons. *First,* the law under which the banks are organized did not contemplate or intend that such use would be made of bank funds. The earlier Comptrollers of the Currency condemned in their annual reports this practice strongly until they lost hope of stirring any bank by their admonitions. The law, they declared, was plain and that it was a direct violation both of its letter and spirit to use their funds in this manner. The *second* objection to using the reserve and other deposits sent by outside banks we have already described. The country is treated to an annual financial scare, of uncertain duration and intensity. For, let us remember, as soon as the balances thus accumulating in the great speculative centers can be better used elsewhere, they are drawn away and the central banks, knowing and expecting this will be done, use them largely in one way—lend them to speculators on call. It is true that the high rates to which money rises tend to correct in some degree the evil, for it tends to keep these balances in the speculative centers instead of recalling them. In time this increase is reflected and the rates of money are raised everywhere to the advantage, it may be, of the banks, but to the injury of the great business interests which have been as innocent of causing this condition of things as if the disturbance had taken place among the inhabitants of the moon. In other words, the banks, by accumulating their balances in New York banks especially and by putting their balances, through the agency of these, into the possession and control of speculators, create almost annually a monetary crisis of longer or shorter length and intensity. The banks are entirely responsible for it, and in many cases unwittingly or otherwise profit thereby. Ought they to be permitted to continue these costly occurrences to business unchecked?

There was a time when banks were forbidden to pay interest on deposits, because experience had proved, so legislatures thought, that, if it was paid, banks would be more anxious to make loans and would run larger risks in making them in order to earn the interest they had promised to pay. Indeed, this principle was regarded so essential to good banking that the restriction was put on the statute book of many states, and still remains unrepealed. If there be any

virtue in this law, can there be anything more contradictory than to permit a bank to pay interest on a reserve fund, knowing that, if this is done, the bank will surely lend the money in order to earn the interest it has agreed to pay? The permission to pay interest on a reserve to the sender implies that the receiver will lend it, otherwise he would not have the slightest wish to receive it or be willing to pay interest thereon. But some states, while still forbidding banks to pay interest on general deposits, permit them to pay on a reserve that may be received, thus clearly recognizing their expectation that the receiving bank will lend the reserve and dissipate it wholly by mingling it in the great volume of circulation. Apply the same rule to the banks which they have so ofen applied by law, or by their own volition, to their own customers—pay no interest to any bank for the use of its deposits. This would effect a speedy and radical cure. For, if a bank were forbidden to receive any interests on its deposits with another bank, it would keep no larger amount with it than its business required. The remainder would be called home for use or safe-keeping.

An objector may say, "You are undertaking too much; man is by nature a gambler, and, on the whole, gambling in stocks, lamentable as it may be, is the least harmful of any kind of gambling." This is doubtless true. But, we maintain, just as the Comptrollers have always maintained, and the courts and all thoughtful law-abiding individuals generally, that the banks, public institutions created by the Government and for the general good, ought not to be perverted to the uses of speculation. It is a known and deliberate violation of law; and it is sad indeed that a practice which has a strong legal condemnation should be so strongly aided and assisted by an agency of the Government itself. If individuals choose to speculate, that is their own affair; it is quite another thing for a governmental agency to aid them in doing what the law condemns. Again, it will be said, if banks cannot get any interest on the use of their deposits, none or only small amounts will be kept in the banks in the larger places, and customers will be obliged to pay more for their exchange, as the banks will have no fund on which they can draw; or at all events will charge for the accommodation. This matter will take care of itself. If it is for the interest of banks to charge their customers for exchange, they will do it; otherwise not; each transaction must stand for itself. If a customer keeps a good balance from

which the bank derives a handsome profit, it will be slow to charge him for a draft; if he is a stranger, or his account is not worth anything or but little, the bank will, and ought to charge him for his draft. There is nothing therefore in this objection. The business would adapt itself to the new conditions, were they to arise.

We will close with a brief summary. *First,* the monetary stringency which has occurred almost annually in the United States for many years, and is felt with greater intensity in New York than in any other place, is caused almost entirely by the action of the banks themselves.

Secondly, if the speculators alone suffered it would not be worth the effort of anyone to improve the situation.

Thirdly, the mercantile interests are the principal sufferers; some years they suffer greatly and it is not just that this class should suffer for the wrongdoing of others.

Fourthly, a partial remedy is to require the national banks to keep their reserves at home, where they will serve as a true reserve.

Fifthly, as a discouragement to country banks which persist in sending or keeping other resources in the larger cities in dull times, especially in New York, knowing they can or will be used chiefly for speculative purposes, they should be forbidden to receive any interest on them.

Sixthly, ancillary to the reserve required by law, an emergency currency should be provided, for the reason that if every bank kept its entire resources at home and loaned them with the utmost prudence, they would not be at instant command. No reserve, however large, is a complete safeguard against the action of depositors or would be complete unless it equaled the entire deposits, and this would be an absurdity. An emergency currency, therefore, which can be put into momentary use—and at the same time one that is safe, satisfying depositors and all subsequent receivers—is the only effective remedy for extraordinary money demands. Were this provided, the very knowledge of its existence would be enough to prevent many of the monetary disturbances which occur. At present our banking system is ruinously defective. Provide an emergency currency and correct the mode of keeping the reserve, and our banking system will be more efficient than any other in the world.

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